Shopping centre and high street bulletin

Q3 2009

"Nerves appear to have continued to calm amongst landlords and retailers'"

- While consumer confidence has begun to improve, we think there will be quite a long wait before spending levels return to normality. On the up-side we expect Christmas 2009 to be reasonably healthy, however political risks abound in 2010, and too early actions on tax and spending may derail a fragile recovery.

- While the downturn in the retail occupational market is by no means over, there are signs that some stability may be emerging. Leasing activity has picked up as retailers hurry to deliver new stores in time for Christmas.

- Investor enthusiasm for high street assets has begun to spill over into the shopping centre sector.

- The shortage of quality stock remains the driver of yield hardening. The depth of demand for riskier assets that are more exposed to the recession and voids is yet to be tested.

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Consumers and retailers

Consumer economy

Economists and commentators alike are all echoing the cry of "are we nearly there yet" when it comes to calling the end of the recession. UK GDP will undoubtedly begin to grow in the final quarter of this year, but as we have often commented this isn't the indicator that effects consumer behaviour. While consumer confidence has improved dramatically over the last four months, it is still resoundingly negative. The question of when it will feel like the recession is over to the nation's shoppers is far more important than when GDP will begin to grow. In our opinion we need to see unemployment beginning to fall, and some clarity on public spending cuts and tax rises before savings rates start to fall and consumer confidence and spending begins to grow. This could be as long away as the end of 2010, or possibly even the Spring 2011 Budget.

After a year of belt-tightening we expect that many households will loosen their purse strings for Christmas 2010. However, with a general election looming the big question for next year is when public spending cuts and tax rises will be implemented, and how deep they will be. We remain of the view that the politician's need to be seen to doing something could be very damaging to the UK economy. A snap post-election Budget too early into the recovery could easily lead to a double-dip in consumer sentiment, with similarly negative implications for the rest of the economy.

The retail occupational market

Nerves appear to have continued to calm amongst landlords and retailers since our last report, and the market seems to be acclimatising itself to the current economic conditions. The uncertainty and divergence of views between landlords and occupiers which prevailed in the early part of 2009 in particular is passing in favour of a clearer understanding of the status quo by both parties.

As a result, letting agents are now reporting a greater through-put of offers from retailers. Retail sales levels are generally improving, giving occupiers greater confidence to exploit the market and expand their store portfolios on good value rental deals. At the same time, landlords have realised and accepted that to replace retailer failures, and fill voids, incentivised deals are now the market norm. A two year package seems to be on most retailers' shopping lists, but bigger incentives than this are far from uncommon. Landlords who can afford it are digging deep to offer big packages to secure the right tenants. This market provides a great opportunity for shopping centre landlords to buy in improved tenant mix.

The improving number of letting deals this past quarter has of course been fuelled in part by retailers' desire to secure new openings in time for Christmas trade. Whether this enthusiasm will be maintained on into 2010 will depend largely on retail sales over the Christmas period. Consumer confidence has improved significantly over the last quarter, but still remains weak.

The greater through-put of deals in the agency market which has filtered through in the last quarter has lead to an easing of the acrimony seen in the rent review market this year. During the previous two quarters, it seems that the majority of retail rent reviews were referred to third party. Surveyors found themselves writing two or three submissions a week, and arbitrators and independent experts have found themselves with an enormous work load of awards and determinations which many are still struggling to clear now.

The cause of this exceptional level of rent review dispute was a lack of completed deals which proved the market sentiment which had prevailed since the third quarter of 2008. Now that deals are being done, rent review surveyors on both sides of the fence have some evidence upon which to base their opinions of value, and reviews are now beginning to be settled by negotiation, rather than at third party.

The fall in retail rents is now beginning to be crystallised in the form of heavily incentivised deals across the country (although it is important to note that there are many pockets of sustained retailer demand at prevailing zone A tones, such as Central London and 100% prime pitches in affluent market towns). General sentiment is that 2010 will remain very much a tenant's market, with great deals available to strong brands and good covenants. Quite how far zone A rates have fallen across the country is still difficult to pinpoint – however it is clear that the concept of tone is all but dead in most retail locations.

Shopping centre investment

Q3 Statistics

- £220m in three deals.
- Average initial yield 8.05% (down 58bps from Q2 2009 at 8.63%)
- Capital value of shopping centres traded this year is £1.196bn

Q3 2009 has seen a marked change in investor sentiment towards the sector. Whilst only three assets have been traded, (two traded in Q2 2009) investors are needing to look 6 months ahead in their acquisition strategies. This is a drastic change from the start of 2009.

The key issue continues to be a lack of available stock on the market. There are just two assets openly being marketed in the towns of Shrewsbury (via Savills) and Silverburn.

These assets are the first to come to the market through the bondholders and banks. It will certainly be very interesting to see what yields these assets are ultimately sold at. Certainly where Savills have an

Investors

involvement sentiment would suggest that pricing achieved on both assets could be significantly in excess of asking terms.

In respect of Silverburn this could move prime yields in 25-50 bps. The expectation is that the sale of these two assets will give the bondholders/banks comfort on the strength and depth of the collective bids on these assets and will encourage further stock to come to a strengthening market. There are just 4 centres under offer.

The number of active shopping centre requirements is now circa 40 and interestingly, with their balance sheets now repaired the REITS are back in force and under pressure to acquire.

We believe that whilst pressures continue in respect of vacancy rates and rental tones yields on shopping centre assets at the prime and town centre dominant end of the spectrum have bottomed out and will now begin to harden. (This can be seen by a 0.58 bps drop in average initial yield of deals transacted in Q3 compared with Q2 2009).

The window of opportunity to acquire shopping centre assets at these historically high yields will continue in the short to medium term. However, indications are that the range and quantum of prospective bidders today is such that opportunities in these areas may only be open for 18-24 months.

	September 2006	September 2009
Prime	4.50%	7.00% -
Mid Market / Strong towns	5.50%-5.75%	8.00% - 8.25%
Secondary	6.00%	9.50%+

High street investment

Enthusiasm for High Street assets has strengthened right across the board. Since last Christmas both private and institutional investors have realised the painful impact of sitting in cash. The stock market has of course seen a significant rally since then but with questions still remaining over the health of the underlying economy, it would be surprising if it there was not a fair amount of profit taking before the end of this year. Property can provide not only a better income return but at the moment also offers the further prospect of capital growth as demand outstrips supply.

The private investor market remains buoyant and with money rates likely to remain extremely low we would anticipate continued strong levels of demand in the months ahead not only in the private treaty market but also at auction. The problem is a lack of quality stock and when a good piece of prime shopping is presented to the investment market yields are being driven down hard especially where the property is well secured and has a long dated income stream.

Some private investors are also seeing this as a chance to secure prime top quality assets where institutional money is not prepared to take occupational risk or accept an over rented position, even if additional yield provides some compensation. Savills had two prime shops in Nottingham under offer just before the summer break and whilst unfortunately the original buyer withdrew from the transaction the gradually strengthening market enabled us to quickly identify a new private investor and even improve upon the original price. All this with the added comfort of two fresh under bidders happy to transact in the quieter summer months.

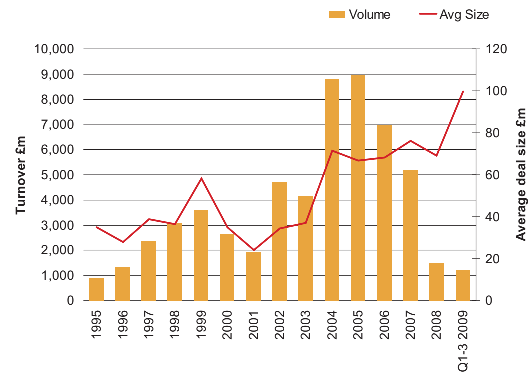
Whilst this strengthening in the private investor market is of interest what has been incredible is the rapid turn around of institutions from sellers to buyers. This has created a ‘double whammy’ – less institutional sellers (and properties withdrawn) and more institutional buyers - forcing prices up. This has caused a material hardening in yields which for prime top quality assets is now over 150 basis points lower than since the turn of the year. Retail funds are enjoying renewed inflows of capital driven by financial advisors having little to offer their clients other than the attractive yield on property. Will these private investors be injured again? At the moment sharpening yields are unlikely to be underpinned by rental growth and with institutions duty bound to invest this new capital the only choice is the limited stock available, not all of which satisfies the full range of criteria ideally required.

All this could lead investors, who perhaps took some bold decisions earlier in the year, to take some profit and for those holding weaker assets it could provide the chance to sell. There is a raft of very poor properties being swiftly prepared for the market, which in many cases even if they are well secured with long unexpired leases, are unlikely to find favour in the more cautious post Lehman’s world.

Today’s low interest rate environment looks here to stay for at least the next 12 months and as such we would anticipate demand to remain strong not only through to the end of the year but also into at least the first quarter of next year. The only thing that could see this pattern changing is continued, or possibly an increase in, occupational distress. Retailer pre-packs are now becoming uncomfortably too common and with them both major and minor town centres will see a dramatic rental recalibration. This will have a significant impact on values. The skill going forward will be to identify well secured assets but in making value assessments try and identify robust towns where rents could hold firm and try and pick up shops let from early 2009 onwards, giving the investor the perfect platform from which to see future rental growth.

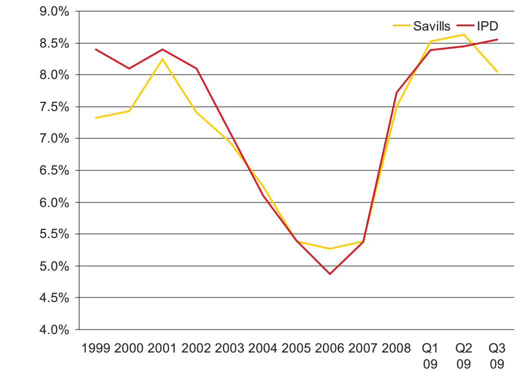
Data

2009 turnover should exceed 2008



Source: Savills

... and average yields have begun to harden



Source: Savills, IPD

Recent significant investment deals

Shopping centre	Size (sq ft)	Purchaser	Vendor	Price	IY
Rams Walk, Petersfield	118,000	Prupim	Prupim	£31m	7.50%
Bullring, Birmingham	1.2m	Australian Govt	Land Securities	£210m	6.85%

High street	Tenant	Purchaser	Term unexpired	Price	IY
82/86 North End, Croydon	Office, McDonalds	Institution	7yrs, 23yrs	£4.53m	6.40%
34/40 Clumber St, Nottingham	Aldo, Abbey National	Private	6.75yrs, 10yrs	£6.00m	6.90%
106 A&B High Street, Winchester	Game, Alliance & Leicester	Private	10yrs, 5yrs	£3.65m	5.38%
210/222 Streatham High Rd	Argos, Peacocks Greggs, Adams	Private	6.25yrs Avg	£4.11m	7.54%

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